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Report to Congressional Committees

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CONSTRUCTION CONTRACTS

Individual Sureties Had No Defaults on Fiscal Year 1991 Contracts

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The Honorable Robert C. Byrd, Chairman
The Honorable Mark O. Hatfield, Ranking
Minority Member
Committee on Appropriations
United States Senate

The Honorable Jamie L. Whitten, Chairman
The Honorable Joseph M. McDade, Ranking
Minority Member
Committee on Appropriations
House of Representatives

This report responds to section 627 of Public Law 101-509, the Treasury, Postal Service and General Government Appropriations Act of 1991, which required us to determine the extent to which contractors used individual sureties to meet bonding requirements on federal contracts and the default rate when individual sureties were used on contracts awarded during fiscal year 1991. As agreed, we focused on federal construction contracts.

Bonding is a guarantee of the performance of a contract or other obligation. A surety is a company or a person that underwrites the guarantee by making itself responsible for the obligation in the event of default on the bond.

As agreed, the report includes specific information on

- the percentage of construction contracts for which individual sureties were used to meet bonding requirements;
- the percentage of total defaults by contractors that used individual sureties;
- the percentage of individual sureties that defaulted on their obligations; and
- the percentage of contracts awarded to minority business enterprises[1] for which individual sureties were used to meet bonding requirements.

The nine Departments and agencies covered in this report awarded about 99 percent of the federal government's construction contracts during fiscal

[1]The term "minority business enterprises" is not defined in Public Law 101-509 or the accompanying conference report. For reporting purposes, we considered minority business enterprises to be small and disadvantaged businesses.

year 1989. The Departments and agencies included were the Departments of Agriculture, Defense, Energy, the Interior, Justice, Transportation, and Veterans Affairs (VA); the General Services Administration (GSA); and the National Aeronautics and Space Administration (NASA). The details of our objectives, scope, and methodology are contained in appendix I.

Results in Brief

Individual sureties were used to meet only a small part of the construction contract bonding requirements in fiscal year 1991. Contractors used individual sureties on 100 of the 8,124 federal construction contracts with bonding requirements awarded that year, and individual sureties accounted for about $338 million of the total construction contract value of $8.7 billion. Of the 1,541 construction contracts with bonding requirements awarded to minority business enterprises in fiscal year 1991, 26 were bonded by individual sureties.

In fiscal year 1991, prime contractors defaulted on 9 of the 8,124 contracts, or about 1 for every 900 awarded that year. None of these nine contracts was bonded by an individual surety.

It appears that changes to the Federal Acquisition Regulation (FAR) effective in February 1990 to curtail abuse by individual sureties were a step toward strengthening management controls over individual sureties. However, because many of the contracts in our review span several years, it would be premature to say that no problems with individual sureties will emerge.

Background

The Miller Act (40 U.S.C. 270a-270f) provides that on all federal construction contracts exceeding $25,000 the contractor must furnish a performance bond for protection of the government and a payment bond to make sure that subcontractors and material suppliers are paid by the contractor for labor and materials provided.

Part 28 of the FAR implements the provisions of the Miller Act. The FAR permits, among other things, using corporate or individual sureties to meet bonding requirements on federal construction projects. A corporate surety is a corporation that is licensed under various insurance laws and under its charter has legal power to act as a surety for others. An individual surety is a person, as distinguished from a business entity, who is liable for the amount of the bond obligation. Annually, the Department of the Treasury publishes a list of acceptable corporate sureties. Individual sureties are

approved directly by the contracting officers in the federal agencies awarding the contracts and are not reviewed and approved by the Department of the Treasury. The guidance to contracting officers for determining the acceptability of individual sureties is available in section 28.203 of the FAR.

Historically, there have been problems with individual sureties. Hearings held by the Subcommittee on Federal Spending, Budget, and Accounting, Senate Committee on Governmental Affairs, in August 1987 disclosed numerous problems, many of which involved nonpayment of suppliers because individual sureties failed to meet their obligations. Further, GSA's Associate Administrator for Acquisition Policy noted more than 275 specific examples of serious problems associated with the use of individual sureties.

In 1988, an interagency task force was established to review the problems with individual sureties and to suggest revisions to the FAR provisions governing individual sureties to reduce the opportunity for abuse. The task force consisted of representatives from the Departments of the Army, Navy, Treasury, Transportation, the Interior, and Veterans Affairs; the General Services Administration; and the Small Business Administration.

When the task force began its work, statistics were not available on how widespread the abuse by individual sureties was or how often individual sureties actually defaulted on their bond obligations. The task force findings on the performance of individual sureties were supported by the experiences of federal agencies that awarded construction contracts.

The group found widespread evidence of problems with individual sureties, including sureties (1) claiming nonexistent assets, assets that they did not have clear title to, and assets of questionable value; (2) providing fictitious financial statements; and (3) not disclosing other bond obligations. Because of these problems, subcontractors and suppliers sometimes were not paid by the individual surety when the prime contractor defaulted. From various offices of Inspectors General and other criminal investigative agencies, the task force also obtained information showing many instances of fraud and abuse by individual sureties.

The FAR was revised to reflect the findings of the Task Force. The changes, effective February 26, 1990, identify and limit the types of assets that can be pledged and require individual sureties to (1) pledge specific assets to cover the amount of the bond obligation, (2) provide objective evidence of

asset ownership and unencumbered value, and (3) establish an escrow account for pledged personal property. The revisions also provide for preventing individual sureties from underwriting government contracts for cause, such as past failure to fulfill bonding obligations, failure to disclose all bond obligations, and misrepresentation of the value of available assets or outstanding liabilities.

The Office of Federal Procurement Policy expected the FAR changes to reduce the number of individuals interested in serving as sureties and strengthen those that remained. Groups representing minority contractors, as well as firms representing individual sureties, opposed these revisions. They were concerned that the revisions were too restrictive and would virtually eliminate individual sureties. They also feared that the elimination of individual sureties could negatively affect small, women-owned and minority-owned businesses because of the difficulty they have in obtaining corporate bonding.

Individual Sureties Were Used Infrequently in Fiscal Year 1991

Individual sureties were used on 100 (about 1.2 percent) of the 8,124 federal construction contracts with bonding requirements awarded in fiscal year 1991 and accounted for about $338 million of the total Miller Act contract value of about $8.7 billion. Almost all (96.3 percent) of the Miller Act construction contracts awarded by the nine agencies covered in this report were bonded by corporate sureties. Table 1 shows the number and percentage of federal construction contracts awarded in fiscal year 1991 that were bonded by corporate and individual sureties. Of the remaining 198 contracts, 182 were secured by other types of collateral, such as certified or cashiers checks, bank drafts, money orders, or currency; the type of surety or collateral was unknown for 16 contracts.

Table 1: Percentage of Corporate and Individual Sureties Used to Meet Bonding Requirements on Federal Construction Contracts Awarded by Nine Agencies during Fiscal Year 1991

Agency	Number of contracts	Corporate sureties used	Percent	Individual sureties used	Percent
Agriculture	924	901	98	11	1.19
Defense	4,634	4,422	95	51	1.10
Energy	73	72	99	0	0.00
GSA	564	560	99	3	0.53
Interior	294	285	97	2	0.68
Justice	81	80	99	0	0.00
NASA	159	153	96	6	3.77
Transportation	572	542	95	18	3.15
VA	823	811	99	9	1.09
Total	**8,124**	**7,826**		**100**	
Overall Percentage			**96**		**1.2**

Defaults Were Minimal on Construction Contracts Awarded in Fiscal Year 1991

In fiscal year 1991, prime contractors defaulted on a total of 9 contracts, or about 1 for every 900 construction contracts with bonding requirements awarded that year. Eight of these contracts were bonded by corporate sureties, and one was secured by another type of collateral. In the eight cases involving corporate sureties, bonding requirements were met. These results are encouraging; however, some problems may still develop because many of the contracts awarded in 1991 will continue for several years.

While contracts awarded in fiscal year 1991 had no surety defaults, defaults did occur in that year on contracts awarded before the strengthened FAR provisions became effective. Forty-eight contracts awarded between September 1984 and February 1990[2] experienced defaults during fiscal year 1991. Of these, four were bonded by individual sureties, and three of these sureties defaulted on their bonding obligations. Forty-two were bonded by corporate sureties, 1 of which defaulted. The remaining two were bonded by other types of collateral, such as certified or cashiers checks, bank drafts, money orders, or currency, and both met their bonding requirements.

[2]Data were not available showing total number of contracts awarded between September 1984 and February 1990.

Minority Business Enterprises Used Individual Sureties to Meet Bonding Requirements on Some Federal Construction Contracts

Minority business enterprises were awarded 1,541, or about 19 percent, of the Miller Act contracts awarded in fiscal year 1991. Twenty-six (about 1.7 percent, or slightly greater than the overall rate of 1.2 percent) of these awards were bonded by individual sureties. These 26 represent 26 percent of the 100 individual sureties that provided bonding on fiscal year 1991 construction projects. Table 2 shows the number and percentage of individual sureties used by minority business enterprises to meet bonding requirements on federal construction projects.

Table 2: Individual Sureties Used by Minority Business Enterprises to Meet Bonding Requirements on Federal Construction Contracts during Fiscal Year 1991

Agency	Minority business enterprise contracts	Individual sureties used	Percent
Agriculture	125	1	0.80
Defense	883	12	1.36
Energy	27	0	0.00
GSA	43	1	2.33
Interior	67	0	0.00
Justice	3	0	0.00
NASA	15	1	6.67
Transportation	134	4	2.99
VA	244	7	2.87
Total	**1,541**	**26**	

Conclusions

It appears the changes to the FAR were a step toward strengthening management controls over individual sureties—federal construction contracts awarded during fiscal year 1991 experienced no surety defaults. However, because many of these contracts will take several years to complete, the absence of defaults at this point does not necessarily mean that all the past problems with individual sureties have been eliminated. While the 1991 data were encouraging, we believe it is still too early to declare that past problems with individual sureties have been resolved. Any problems with individual sureties that could develop under the strengthened procedures may not be apparent for some time.

Officials of the Office of Procurement Policy, which collected the data on which this report is based, reviewed a copy of the report and concurred in its conclusions.

As arranged with the Committees, we are sending copies of this report to the Departments of Agriculture, Defense, Energy, the Interior, Justice, Transportation, and VA; GSA; NASA; and other interested parties. We will also make copies available to others upon request.

The major contributors to this report are listed in appendix II. If you have any questions concerning this report, please contact me on (202) 275-8676.

L. Nye Stevens

L. Nye Stevens
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Objectives, Scope, and Methodology

Section 627 of Public Law 101-509, the Treasury, Postal Service and General Government Appropriations Act, 1991, required us to provide information on the extent to which individual sureties were used to meet bonding requirements on contracts awarded during fiscal year 1991. Our objectives were to determine the extent to which contractors used individual sureties to provide bonding for federal contracts and the default rate when individual sureties were used. As agreed, we focused on federal construction contracts to determine the (1) percentage of construction contracts for which individual sureties were used to meet bonding requirements, (2) percentage of total defaults by contractors using individual sureties, (3) percentage of individual sureties that defaulted on their bonding obligations, and (4) percentage of contracts awarded to minority business enterprises for which individual sureties were used to meet bonding requirements. We obtained data from nine federal agencies that awarded the largest numbers of federal construction contracts during fiscal years 1988 and 1989. Those agencies were the Departments of Agriculture, Defense, Energy, the Interior, Justice, Transportation, and Veterans Affairs, and GSA and NASA. These nine agencies represented 99 percent of the federal construction contract dollars awarded in fiscal year 1989, which was the most current data available when we began our work.

The Office of Federal Procurement Policy (OFPP) of the Office of Management and Budget, which collected the data for us, designed a computer-based system to collect the required data. We met with OFPP staff on several occasions and discussed the data collection and analysis system used to compile the information and data collection as it progressed. OFPP officials reviewed a draft of this report and agreed with its conclusions.

In order to assure ourselves that the submitted data were processed correctly, we reviewed

- the design of the computer-based software system;
- the data-gathering instructions to the responding organizations and accompanying computer-based data collection instruments;
- the data communications procedures;
- the established procedures for helping organizations properly complete the information request;
- the computer-based edit checks, error detection routines, and correction procedures; and
- software routines used to summarize the data.

Because the requested data were not available until March and our report was required by April 1, 1992, we did not independently verify the accuracy or completeness of the data submitted to us by OFPP.

We did our work between June 1991 and March 1992, in Washington, D.C., in accordance with generally accepted government auditing standards.

Major Contributors to This Report

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